Dairy production is the foremost agricultural activity of the European Union, accounting for around 18% of the total value of Community agricultural output. Despite a decline in its market share, the Union still ranks as the world’s chief exporter of dairy products.

The CAP reform under Agenda 2000 has not fundamentally affected the common organisation of the market (COM) in milk and milk products established in 1968 and subsequently revised in depth in 1984 to introduce milk quotas and in 1987 to scale down buying-in. The changes introduced to ensure the sector’s stability and competitiveness essentially involve a progressive reduction in institutional prices from 2005 on, partly offset by direct payments to producers. The quota system is up for review in 2003 with a view to its discontinuation after 2006.


The motives behind the CAP reform

The reform of the common agricultural policy adopted by the European Council held in Berlin on 24 and 25 March 1999 seeks to equip Europe’s agriculture to take up the challenges that will face it internally and externally in the early 21st century.

The reform aims to foster a more competitive, more environmentally friendly farming industry. It also marks a further step towards a policy that provides support for farmers rather than subsidies for products and that remunerates farmers not only for output but also for the extra contribution they make to society.

The reform will also provide a foundation for the Union’s position in the forthcoming round of multilateral trade negotiations launched at the beginning of 2000 by the World Trade Organisation (WTO).

In the longer term, the reforms now undertaken will create the right conditions for adjustment among the agricultural economies of the applicant countries, whose adaptation will be eased by funding under the pre-accession structural measures.

Taking up the new challenges

Agricultural markets are increasingly caught up in the global economy. The reform must enable Europe’s farming industry to play a bigger part in this process and to gear production to actual demand, with due attention to consumer concern for quality. The lower intervention prices contemplated by the reform, in particular for cereals and beef, will lead to lower prices on the market, so making agricultural production more competitive and bringing it more closely into line with demand.

Higher direct payments to farmers and increased aid per hectare or per head of livestock will help stabilise their incomes.

It is now recognised that rural development forms a second pillar of the CAP, the objective being to improve the economic and social integration of all rural areas. To achieve this, a single regulatory framework will make it easier to apply measures for developing agricultural activities in rural areas and diversifying the economy there. In particular, the agri-environmental schemes have been bolstered.

The reform also seeks to foster more environmentally friendly production methods by introducing cross-compliance, whereby direct payments are made subject to compliance with environmental criteria.

National authorities are to be allowed greater latitude when implementing the reform in order to bring the CAP closer to public perceptions in general and the realities faced by farmers in particular. While complying with Community criteria to prevent distortions of competition, some of the aid distributed will thus vary in accordance with national criteria, or will be decentralised for allocation in “national envelopes” administered by the Member States in line with their own requirements. This more flexible policy means a wide range of situations can be dealt with appropriately.
The new market organisation for milk and milk products

Prices
The intervention prices for butter and skimmed-milk powder will be cut by 15% in three equal steps as from the 2005/06 milk year (see table below). This will encourage consumption on the internal market and make the Union’s milk products more competitive on international markets. For milk (3.7% fat content), price support will continue to be based on a target price (see page 8).

Intervention
While gradually reducing price support, the reform keeps intervention as a way of helping to stabilise market prices and protect farmers’ incomes. Intervention involves buying in butter and skimmed-milk powder (these products must comply with the conditions laid down in the Regulation on the COM) and granting aid for private storage.

Where butter prices in one or more Member States fall below 92% of the intervention price (see table below) for a representative period, the intervention agencies buy in butter by invitation to tender in the Member State(s) concerned. The buying-in price set by the Commission cannot be less than 90% of the intervention price. Intervention is applied so as to maintain butter’s competitive position on the market, preserve the butter’s original quality and store it as rationally as possible.

Skimmed-milk powder is bought in at the intervention price by the intervention agency designated by the particular Member State. The price is that applicable on the day of manufacture of the product (delivered to the store designated by the intervention agency). The Commission can suspend buying-in once the quantities offered from 1 March to 31 August each year exceed 109 000 tonnes. In that event, the intervention agencies may issue standing invitations to tender to buy in skimmed-milk powder.

Aid may also be granted for the private storage of certain milk products where prices and stocks indicate a serious imbalance on the market that can be reduced by seasonal storage. The products concerned (on conditions set out in the Regulation on the COM) are butter, cream¹, skimmed-milk powder² and certain cheeses (Grana padano, Parmigiano reggiano, Provolone, long-keeping cheeses and sheep’s and goat’s milk cheese). The aid is based on the storage costs and the foreseeable development of market prices. Where the situation on the market so requires, the Commission can decide to release some or all of the products in storage onto the market.

¹ Cream obtained directly and exclusively from milk.
² Cow’s milk produced in the Community.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Butter: intervention price</td>
<td>328.20</td>
<td>311.79</td>
<td>295.38</td>
<td>278.97</td>
</tr>
<tr>
<td>Skimmed-milk powder: intervention price</td>
<td>205.52</td>
<td>195.24</td>
<td>184.97</td>
<td>174.69</td>
</tr>
<tr>
<td>Milk (3.7% fat content, delivered to dairy): target price</td>
<td>30.98</td>
<td>29.23</td>
<td>27.47</td>
<td>25.72</td>
</tr>
</tbody>
</table>

¹ These prices may be amended by the Council (agriculture ministers). The prices are set irrespective of additional levies applied under the milk quota system.
² The milk year starts on 1 July each year and ends on 30 June of the following year.
The CAP reform: Milk and milk products

Direct payments to producers

To limit the impact of the planned reduction in intervention prices and so help stabilise agricultural income, direct payments to producers will be financed by the Community as from the 2005/06 marketing year (see table above). These direct payments will be of two types, i.e. a fixed payment (the dairy premium) and additional payments.

The dairy premium will be granted per calendar year, per holding and per tonne of individual reference quantity.

Additional payments may be granted by the Member States in their territory for up to the global amounts set per country on the basis of their share of total Community production (see table opposite: national envelopes). This enables the Member States to respond more flexibly to the dairy industry’s needs, which vary greatly from one Member State to another. These payments will be made on the basis of objective criteria, including production structures and conditions, in order to ensure equal treatment between producers and to avoid market and competition distortions. The additional payments comprise:

- "top-up" premiums (premium supplements), which may be granted only as a supplement per dairy premium amount per tonne
- area payments granted per hectare of permanent pasture.

<table>
<thead>
<tr>
<th>Calendar year</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>8.6</td>
<td>17.1</td>
<td>25.7</td>
</tr>
<tr>
<td>Denmark</td>
<td>11.5</td>
<td>23.0</td>
<td>34.5</td>
</tr>
<tr>
<td>Germany</td>
<td>72.0</td>
<td>144.0</td>
<td>216.0</td>
</tr>
<tr>
<td>Greece</td>
<td>1.6</td>
<td>3.3</td>
<td>4.9</td>
</tr>
<tr>
<td>Spain</td>
<td>14.4</td>
<td>28.7</td>
<td>42.1</td>
</tr>
<tr>
<td>France</td>
<td>62.6</td>
<td>125.3</td>
<td>187.9</td>
</tr>
<tr>
<td>Ireland</td>
<td>13.6</td>
<td>27.1</td>
<td>40.7</td>
</tr>
<tr>
<td>Italy</td>
<td>25.7</td>
<td>51.3</td>
<td>77.0</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>0.7</td>
<td>1.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Netherlands</td>
<td>28.6</td>
<td>57.2</td>
<td>85.8</td>
</tr>
<tr>
<td>Austria</td>
<td>7.1</td>
<td>14.2</td>
<td>21.3</td>
</tr>
<tr>
<td>Portugal</td>
<td>4.8</td>
<td>9.7</td>
<td>14.5</td>
</tr>
<tr>
<td>Finland</td>
<td>6.2</td>
<td>12.4</td>
<td>18.6</td>
</tr>
<tr>
<td>Sweden</td>
<td>8.5</td>
<td>17.1</td>
<td>25.6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>37.7</td>
<td>75.4</td>
<td>113.1</td>
</tr>
<tr>
<td>Total</td>
<td>303.6</td>
<td>607.2</td>
<td>902.6</td>
</tr>
</tbody>
</table>

Marketing

On top of the intervention mechanisms described above come various types of marketing aid that are designed to encourage balanced management of the market in dairy products and to stabilise prices in the sector.
The products eligible for such aid comprise skimmed milk and skimmed-milk powder for use as feedingstuffs, on condition that they meet certain standards. The aid is set taking account of factors like the intervention price for skimmed-milk powder, the supply situation for skimmed milk and skimmed-milk powder, calf prices and market prices for proteins competing with skimmed-milk powder.

Aid may also be granted for skimmed milk produced in the Community and processed into casein and caseinates, for the purchase, at reduced prices, of cream, butter and concentrated butter (in particular by non-profit making institutions and organisations and manufacturers of pastry products and ice-cream) and for the distribution of processed milk in educational establishments.

**Milk quotas**

Since 1984, milk quotas have helped regulate dairy production while ensuring that production can take place across the regions of the Union. As the reform of the COM is to apply for prices and direct payments as from the 2005/06 milk year, the current quota system is to be extended from April 2000 to March 2008. In 2003, however, it will come up for review on the basis of a report from the Commission with a view to its discontinuation after 2006.

The reform of the COM will take place irrespective of any decisions allocating specific additional milk quotas. The quotas will be increased by around 2.4%, in part in the form of specific national envelopes and for the rest as a flat-rate increase of 1.5%. The rules for administering the quotas have also been adjusted, with a view in particular to ensuring that the aid is granted to the most efficient milk producers and to newcomers.

**Trade with third countries**

The new Regulation on the COM for milk and milk products updates the provisions on trade with third countries in the light in particular of the situation arising from the Agreements concluded under the Uruguay Round of multilateral trade negotiations. While it may draw on methods used in the past (allocation by chronological order of applications received, as a proportion of the quantity applied for or by reference to traditional trade flows) when administering the tariff quotas under those Agreements, the Commission may also apply other suitable approaches, without prejudice to the rights arising from the Agreements. The goal is to satisfy the Community market’s supply needs and safeguard its balance. The Commission sets export refunds periodically or by invitation to tender for products where the previous Regulation so provided.

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<table>
<thead>
<tr>
<th>Member States</th>
<th>Distribution</th>
<th>Direct sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>3 140 696</td>
<td>169 735</td>
</tr>
<tr>
<td>Denmark</td>
<td>4 454 640</td>
<td>708</td>
</tr>
<tr>
<td>Germany</td>
<td>27 767 036</td>
<td>97 780</td>
</tr>
<tr>
<td>Greece</td>
<td>629 817</td>
<td>696</td>
</tr>
<tr>
<td>Spain</td>
<td>5 457 564</td>
<td>109 386</td>
</tr>
<tr>
<td>France</td>
<td>23 793 932</td>
<td>441 866</td>
</tr>
<tr>
<td>Ireland</td>
<td>5 236 575</td>
<td>9 189</td>
</tr>
<tr>
<td>Italy</td>
<td>9 698 399</td>
<td>231 661</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>268 098</td>
<td>951</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10 991 900</td>
<td>82 792</td>
</tr>
<tr>
<td>Austria</td>
<td>2 543 979</td>
<td>205 422</td>
</tr>
<tr>
<td>Portugal</td>
<td>1 835 461</td>
<td>37 000</td>
</tr>
<tr>
<td>Finland</td>
<td>2 394 528</td>
<td>10 000</td>
</tr>
<tr>
<td>Sweden</td>
<td>3 300 000</td>
<td>3 000</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>14 373 969</td>
<td>216 078</td>
</tr>
</tbody>
</table>

1 Including buttermilk and buttermilk powder.
Cross-compliance, modulation of payments

Direct payments to producers are governed by common rules for direct support schemes under the CAP laid down in the new “horizontal” Regulation (EC) No 1259/1999. The rules provide, first, for an obligation on the Member States to lay down suitable environmental measures to be implemented by farmers and allow payments to be made subject to compliance with general or specific environmental requirements or agri-environmental commitments entered into by farmers. Secondly, they provide for such payments to vary by holding, depending on the labour employed or overall earnings. Funds not spent through a failure to comply with the environmental conditions or as a result of the modulation of payments will remain available to the Member States as additional Community support for the financing of agri-environmental measures, afforestation of farmland, compensatory allowances in less-favoured areas and areas with environmental restrictions, and early retirement schemes.

Quality marks: PDOs-PGIs-TSG

Dairy products and in particular cheeses figure prominently among the hundreds of products registered under the system of Community quality marks introduced in 1992 to exploit the quality of agricultural products and bolster the competitiveness of Europe’s agri-food industry. Such products are made using recognised know-how and can be linked with a particular geographical area at the production, processing and preparation stages (Protected Designation of Origin – PDO) or at least one of those stages (Protected Geographical Indication– PGI), or their specific features are due to a production method or traditional composition without any link with a particular area (Traditional Speciality Guaranteed – TSG).

A new opening: organic farming

Organic farming is a production method in which the greatest attention is paid to environmental protection and animal welfare. The resulting products are obtained without using synthetic fertilisers or pesticides, antibiotics, growth hormones or genetic engineering.

With a growth rate of 25% a year in the EU, a cultivated area that has more than doubled in five years (from some 890 000 ha in 1993 to nearly 2 210 000 ha in 1997) and promising forecasts for forthcoming years, organic farming is an expanding market that reflects the change in the consumer’s expectations and concerns.

Dairy products can now qualify for the Community guarantee to consumers for organically produced agricultural products: previously confined to plant products, the scope of the Community Regulation has been extended to cover products of animal origin (Regulation (EC) No 1804/1999). A Community logo for organic products was published in February 2000.

Simplification

Alongside the reform of the CAP, a significant effort is being made to simplify agricultural legislation. The new Regulation on the COM for milk and milk products incorporates provisions previously contained in nine Regulations. The basic Regulation sets the target and intervention prices for a number of years. The implementing Regulations are grouped together and, where possible, simplified.
Milk and milk products: What products are covered?
The COM for milk and milk products lays down rules covering the following categories of products:
- Milk and cream, not concentrated or containing added sugar or other sweetening matter
- Milk and cream, concentrated or containing added sugar or other sweetening matter
- Buttermilk, curdled milk and cream, yogurt, kephir and other fermented or acidified milk and cream, whether or not concentrated or containing added sugar or other sweetening matter, not flavoured or containing added fruit, nuts or cocoa
- Whey, whether or not concentrated or containing added sugar or other sweetening matter; products consisting of natural milk constituents, whether or not containing added sugar or other sweetening matter, not elsewhere specified or included
- Butter and other fats and oils derived from milk; dairy spreads with a fat content of more than 75% but less than 80%
- Cheese and curd
- Lactose and lactose syrup not containing added flavouring or colouring matter, containing by weight 99% or more lactose, expressed as anhydrous lactose, calculated on the dry matter
- Flavoured or coloured lactose syrup
- Preparations of a kind used in animal feeding.

Various products’ shares of EU final agricultural production (1998)

1. Beef/veal: 10.1%
2. Pigmeat: 10.0%
3. Fresh vegetables: 9.4%
4. Cereals (excluding rice): 9.2%
5. Wine and grape must: 6.6%
6. Poultry: 5.4%
7. Other: 31.3%

Milk’s share of Member States’ final domestic production (1998)

Netherlands: 22.3%
United Kingdom: 22.8%

Ireland: 34.7%
Belgium: 15.3%
France: 16.5%
Portugal: 14.8%
Spain: 7.8%

Denmark: 24.2%

Finland: 38.1%
Sweden: 34.9%
Germany: 26.4%
Luxembourg: 45.4%
Austria: 22.0%
Italy: 11.8%
Greece: 13.4%

Source: Directorate-General for Agriculture
The Community market: situation and outlook

In 1998, cow’s milk production amounted to around 120.5 million tonnes (by comparison, the US figure was 72 million tonnes), most of which (75%) was accounted for by five Member States (Germany, France, United Kingdom, Netherlands and Italy). Community milk utilisation in various types of products broke down as follows: drinking milk (29 million tonnes), cheese (6.7 million tonnes), butter (1.8 million tonnes), skimmed-milk powder (1.1 million tonnes), whole-milk powder (0.9 million tonnes).

The European Union maintained its position as foremost world exporter with 15 million tonnes (milk equivalent) while EU imports amounted to 3.6 million tonnes and internal consumption was 111 million tonnes (including some 10 million tonnes for subsidised consumption and 7 million tonnes used on the farm). The situation on the internal market has worsened gradually since early 1998, mainly on account of stagnation in demand on international markets in the wake of the economic crises in Russia, Asia and South America. Exports of milk powder were first affected, followed by cheese in late 1998.

Despite fairly stable internal consumption in the EU, the market prices for most dairy products began falling and quantities had to be bought in to support the market. Public stocks of skimmed-milk powder started to accumulate in 1996, topping 200 000 tonnes in September 1998 and climbing to 236 000 tonnes in October 1999. Insignificant in early 1999, public butter stocks amounted to only 50 000 tonnes in October, barely the minimum safety margin needed for proper management of the market. The trends for per capita dairy consumption vary widely depending on the product, rising for some (cheese and cream), sluggish for others (drinking milk and concentrated milk), or even falling (skimmed-milk powder and butter).

Long-term projections (to 2005/2006) point to a substantial growth in world trade and the likelihood of a fall in the EU’s share of the market for many dairy products. Forecasts also indicate a structural increase in the size of Community dairy holdings, in turn leading to a rise in milk output. While the most competitive producers have sizeable room for manoeuvre, for newcomers and producers wishing to increase their output the possibility of purchasing or leasing quota without shackling themselves with an excessive extra cost burden is extremely important. The 2003 review of the quota system and the reform of the COM from 2005 should help to establish balance on the market and improve the EU dairy industry’s export prospects.
Short glossary

- **Intervention price**: for butter: the price used as a basis by intervention agencies to buy in, under a standing invitation to tender, quantities offered that meet the regulation quality criteria, provided buying-in is not suspended; for skimmed-milk powder: the price at which the intervention agencies in the Member States are required to buy in, for public storage (= intervention buying-in), quantities of skimmed-milk powder meeting the regulation quality criteria and offered by producers during the buying-in period, provided buying-in is not suspended.

- **Target price** for milk delivered to dairies, containing 3.7% milk fat: the price it is sought to obtain for the aggregate of producers’ milk sales during the milk year on the Community and external markets.

- **Milk quotas**: milk production quantities broken down among the Member States and among producers (individual quotas) in each Member State, with a view to achieving balance between supply and demand and curbing production surpluses in the Community. Where there is an overrun in the national quota, an additional levy is payable by the Member State concerned, which passes it on, in accordance with certain national rules, to the producers who contributed to the overrun.

- **Import/export licence**: a document issued by the Member States to all Community applicants for presentation in connection with any imports into or exports from the Community. The Commission determines the list of products for which export licences are required and the term of validity of the licences.

- **Import duty** (payable by the Community importer): specified by the arrangements on trade in dairy products with third countries and subject to limits under international trade agreements. The common customs tariff rates of duty apply to dairy products. To overcome the damaging effects of certain imports on the Community market, an additional import duty may be levied on the products in question on the basis of the cif import price of the consignment concerned (cif = cost insurance freight, i.e. the cost of the product + insurance + transport costs). In such cases, tariff quotas established under international agreements are opened for the third countries concerned and administered by the Commission with a view to preventing any discrimination between the operators involved.

- **Export levy** (payable by the Community exporter): this may be applied by the Commission in exceptional circumstances (where EU supplies are threatened) with a view to stabilising prices and ensuring balance on the internal market.

- **Export refunds** (paid to the Community exporter): these are intended to make up for the difference between Community and world prices with a view to ensuring stability on the Community market. When setting refunds, the Commission also takes account of factors like the most favourable marketing and transport costs, and international agreements. The latter set ceilings on quantities and funds for export refunds. The method applied for allocating the quantities qualifying for the refund on exports must be that best suited to the particular type of product and the situation on the market concerned and the one that involves least red tape for operators, bearing in mind the needs of management. Refunds are the same throughout the Community but may vary by destination where the market situation requires. They are paid where proof is provided that the products originate in, and have been exported from, the Community.

Further information

Further information on the CAP and the reform is available on the Agriculture DG’s website <http://europa.eu.int/comm/dg06/index.htm>. The Regulations on the following in particular are available for consultation on the site:

- The common organisation of the market in milk and milk products: Regulation (EC) No 1255/1999
- Common rules for direct support schemes under the common agricultural policy (horizontal Regulation): Regulation (EC) No 1259/1999
- The financing of the common agricultural policy: Regulation (EC) No 1258/1999
- Support for rural development: Regulation (EC) No 1257/1999
- Quality marks: Regulations (EC) No 2081/92 and No 2082/92. The list of products may be consulted at <http://europa.eu.int/qualityfood>.